

Summary of Interested Parties Meeting Regulation §251137-11, Trucking

- I. **Administration:** On July 17, 2008, at 10:00 a.m., members of the public attended an interested parties meeting at the Franchise Tax Board office in Sacramento. Parties attended in person and by telephone with those present including trucking company representatives, trucking association representatives, accounting and law firms, and tax administrators from other states. Those physically present were asked to register at the entrance and all participants introduced themselves. The session was to be tape recorded, but the ensuing recording was inaudible.

The Hearing Officer, Laurie McElhatton, explained that the regulation had functioned adequately for many years, and only recently issues have been raised. Ms. McElhatton opined that while there does not appear to be a need for comprehensive substantive revision of Regulation §25137-11, this public forum is offered as a part of the current regulation review process to discuss whether any clarifications are needed. A discussion outline and accompanying diagram were distributed for reference during the discussion.

- II. **"Trucking Company" definition in Regulation §25137-11(b)(1) (Scenario #1):**
Discussion opened with whether the definition of "trucking company" in subdivision (b)(1) needs to be clarified. Parties discussed advantages and disadvantages of three sample amendments provided in the discussion outline. Ms. McElhatton explained the facts of the recent California State Board of Equalization case, *Appeal of Swift Transportation*. Following extensive discussion, those present indicated their preference for the option presented in "Example 3" from the handout, which called for additional language to be inserted at the end of subdivision (b)(1) of the trucking regulation.
- III. **"Trucking Activity" definition in Regulation §25137-11(b) (Scenario #2):**
Discussion proceeded as to whether a definition of "trucking activities" should be added to subdivision (b) of the regulation, and if so, what form it should take. Reference was made to the "trucking company" definition at subdivision (b)(1) as a possible model with alterations, including deletion of the phrase "of others." A comment was made that this term would not be appropriate in a "trucking activities" definition because the term "trucking activities" refers to trucking performed on behalf of other members of the unitary group. Accordingly, there would be no movement of freight for third parties or "others." In addition, there was discussion of whether "compensation" would also need to be deleted. While compensation may be involved, it would also likely be eliminated if a trucking company transported cargo for other members in a unitary group. A suggestion was made that language would need to be inserted stating that "trucking activities" includes activities performed by unitary group members to avoid the issue raised in *Appeal of Swift*. There was general discussion on the level of specificity required to have a regulation function as intended. Public response to

the possibility of proposing a definition of "trucking activities" was generally neutral.

- IV. **Diverse Businesses (Scenario #3)**: This scenario was based on a hypothetical trucking operation that was unitary with a mining operation. Previous discussions during the meeting covered how existing Regulation §25137-11 would apply to this fact pattern so that subdivisions (c)(2), (3), and (4) of the regulation would only apply to the mobile property, mobile payroll, and receipts from freight movement by trucking operations. For the portions of the mining operation without mobile property, mobile payroll, or freight movement, standard apportionment sections outside of the trucking regulation would govern as discussed in subdivision (c)(1). The members of the public in attendance seemed to understand how this scenario would be treated under the current Regulation §25137-11.
- V. **Freight Forwarding**: Discussion continued to the freight forwarding issue. It was explained that freight forwarding refers to arrangement of shipments that are carried out by third parties that use their own trucks and drivers to move the freight. Hence, there are no property or payroll factors from these shipments, only a sales factor.

There was a general consensus that the issue for freight forwarding is whether or not receipts of freight forwarders should be governed by Regulation §25137-11. Discussions took place where it was observed generally that currently freight forwarding is not governed by the trucking regulation unless it is undertaken as part of a unitary trucking business. Rather, it is governed by RTC §25136. If that section does not lead to an apportionment factor that fairly reflects the California activities of the taxpayer, then RTC §25137 may be applied and an alternative formula used. A comment was made that sometimes a 50/50 rule has been applied, whereby half the receipts are assigned to the point of origin and half to the point of destination. One idea was to include this 50/50 approach in a regulation. A comment was made that there might be an opt-out provision if the facts do not support a 50/50 assignment. There was an area of concern expressed as to how a 50/50 freight forwarding regulation would overlap with the use of independent contractors ("purchased transportation"), if at all.

There was discussion regarding an 80/20 rule used in other states and an inbound/outbound ratio. Dissatisfaction was expressed with states that use a ton-miles ratio. A question was raised about whether headquarter costs should be included. A comment was made that the interstate ratio should apply to freight forwarders that are trucking companies making arrangements for shipments using other trucking companies or owner-operators to move the freight.

There was general discussion about where the costs of performance are located for freight forwarders. Some parties indicated a preference to leave the situation "as is" so that RTC §25136 and RTC §25137 are applied on a case-by-case basis.

- VI. **Independent Contractors:** There was discussion on the different types of independent contractors and that sometimes the word "contract" is used to refer to these situations. Staff received input that there are owner-operators who are hired by trucking companies as well as third party trucking companies that are hired by trucking companies. Both are technically "independent contractors." Discussion continued reflecting that if the taxpayer trucking company provides the tractor and/or trailer that are driven by the independent contractor, then the mileage ratio should apply. In that situation there is no payroll factor for that shipment, but there are receipts and property assigned using the interstate ratio. Discussion followed regarding how to assign the receipts when the independent contractor drives its own vehicle for the trucking company taxpayer.

There was discussion about difficulties encountered by trucking companies in tracking the mileage of third party trucking companies. There may be instances where the mileage is available, such as with owner-operators, but when a third party trucking company is hired, the mileage may be more difficult to obtain for a variety of reasons. There was discussion about using known mileage only and excluding unknown mileage, though this leaves a choice situation that may not be optimal and may lead to sales factor skewing, depending on how the trucking operation is carried out.

There were comments that the hiring of independent contractors who drive their own vehicles is not equivalent to freight forwarding. Discussions followed about whether to apply a RTC §25136 cost of performance analysis to the receipts paid for shipments carried out by independent contractors driving their own vehicles, in which case the costs for each shipment would need to be separately analyzed, or whether to apply the interstate ratio from Regulation §25137-11. A comment was made stating a preference for applying the interstate ratio to receipts paid for shipments carried out by independent contractors driving their own vehicles. The public did not seem opposed to using the interstate mileage ratio in these purchased transportation situations. The question is what to do in situations where mileage figures cannot be obtained.

- VII. **Other Concerns:** A question was raised as to whether the "trucking company" definition should refer to "owned" motor vehicles. The consensus was generally negative because to do so would not include companies that employed independent contractors who own their own trucks.